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OCI No. 1586/63

CENTRAL INTELLIGENCE AGENCY
Office of Current Intelligence
26 July 1963

MEMORANDUM

SUBJECT: Reaction to US Foreign Securities Tax

1. The reaction abroad to the President's program to ease the balance-of-payments problem has been generally favorable. Adverse comment, however, has been directed against the proposal for a tax on US purchases of foreign securities.

2. Mounting criticism of the tax has been engendered in the last few days by the postponement of the tax's effective date, the exemption of Canadian securities, and the rumors that some special provision for Japan is also under consideration. The reservations of Europeans have been given abundant expression in the French and British press as well as in Common Market circles. EEC Vice President Marjolin, for example, has publicly referred to the tax as a US effort to curtail exports of long-term capital to "certain countries," and has noted that the long and varied experience of European countries in controlling capital movements "taught them that effective pressure in this field is not easily brought to bear." Marjolin added it was to be hoped that the US would pursue other measures--notably the reduction of domestic taxes--to ensure that more savings are set to work at home.

3. The Marjolin statement followed a meeting of the EEC's monetary committee at which the proposed securities tax was reviewed in considerable detail. The committee, it seems, welcomed energetic US action to reduce its payments deficit, and did not fault the idea that control over long-term capital outflow is the area where corrective action is urgently needed. In their deliberations, however, committee members reportedly were troubled by some features of the securities tax. The Canadian exception and alleged successive changes in the scope of the tax caused them to question whether the measure would, in fact, be of

any practical value. They were also concerned about the prospect that the US might have to resort to exchange controls. In the absence of such controls, it was suggested that short-term funds could be transferred abroad to purchase securities in foreign markets.

4. It is too early to say how strongly these negative views are held. Ambassador Tuthill reports that it is not clear to him whether the European concern over the Canadian and the rumored Japanese exemptions reflects mainly resentment against discrimination or a belief that the exception is so large as to render the tax ineffective. (Out of the billion dollar net outflow of US funds for purchases of foreign securities last year, Canadian securities comprised the largest category--almost 400 million; another 100 million represented US purchases of Japanese securities.) Tuthill, however, believes that a series of announced changes in the balance-of-payments program anytime soon might be interpreted as reflecting indecision and uncertainty on the part of the US and be exaggerated in some European circles beyond their significance per se.

5. In any event, the Europeans fully recognize that the problem which the US faces requires curbs on the outflow of capital. Indeed, there appears to be a considerable body of opinion that fully effective curbs would require restrictions on direct as well as portfolio investments. There is some feeling, however, in countries like Italy, Norway, and the Netherlands that the proposed tax could disrupt European plans to raise new capital and suggests some uneasiness that an international deflationary effect might result from too restrictionist a policy on US capital investments.

6. Outside Western Europe and Canada, the sharpest reaction to the President's message has occurred in Japan where security prices dropped precipitously last week. Both the prime minister and minister of finance have privately expressed grave concern, and the Japanese ambassador in Washington has been instructed to request exemption of Japanese securities from the proposed tax. Anticipating that the tax, if enacted, would worsen the Japanese balance-of-payments position,

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Tokyo has intimated that it may have to move slowly in making any new aid commitments to underdeveloped countries. It is also hinting that pressures for expanded trade with the bloc are likely to build up. Bank of Japan authorities are more inclined to approve the President's message, but even these officials profess surprise that the US has had to resort to such drastic action.